

STATE OF FLORIDA

EX PARTE OR LATE FILED

Commissioners:  
JULIA L. JOHNSON, CHAIRMAN  
SUSAN F. CLARK  
J. TERRY DEASON  
JOE GARCIA  
DIANE K. KIESLING



GENERAL COUNSEL  
ROBERT D. VANDIVER  
(904) 413-6248

**Public Service Commission** FCC MAIL ROOM

April 9, 1997

APR 10 1997

RECEIVED

**BY AIRBORNE EXPRESS**

Mr. William Caton  
Secretary  
Federal Communications Commission  
1919 M Street NW, Room 222  
Washington, DC 20554

Re: CC Docket 96-45 - Universal Service and CC Docket 96-262 - Access Charge  
Reform - EX PARTE FILING

Dear Mr. Caton:

As addressed in our March 28 ex parte filing, Chairman Julia Johnson made presentations to Chairman Reed Hundt, and to the other Commissioners Wednesday and Thursday, March 26 and 27, 1997, regarding her proposal on universal service and access reform. We included a summary of those discussions. She also disseminated the attached letter, so we want to also provide this for the record.

Pursuant to Rule 1.1206, an original and one copy are being submitted to the Secretary.

Sincerely,

A handwritten signature in cursive script, appearing to read "Cindy Miller".

Cindy Miller  
Senior Attorney

CBM:jmb  
Attachment

No. of Copies rec'd  
List ABCDE

041

STATE OF FLORIDA

JULIA L. JOHNSON  
CHAIRMAN



CAPITAL CIRCLE OFFICE CENTER  
2540 Shumard Oak Boulevard  
Tallahassee, FL 32399-0854  
(904) 413-6044

**Public Service Commission**

March 27, 1997

FCC MAIL ROOM

APR 10 1997

RECEIVED

The Honorable Reed Hundt  
Chairman  
Federal Communications Commission  
1919 M Street NW  
Washington, D.C.

Dear Chairman Hundt:

At a meeting with several state commissioners, as well as at the NARUC Winter Committee Meetings, you outlined your current thoughts on how universal service should be funded, and how interstate access charges should be reduced. In a true spirit of federal/state partnership, you encouraged state commissioners to comment on your ideas and inform you of those ideas with which we agreed, as well as provide you with alternative ideas that we believe should be considered.

I have given extensive thought to your proposal. I started my review using the three fundamental principles of the federal Act you articulated at our meetings: Pro-Competition, Deregulation, and Universal Service. I added one key question as I applied the principles of the Act to your proposal: what will be the likely impact of the proposal on the local ratepayer or consumer?

Generally, in applying the principles and asking the question, I found that I supported many of the elements of your proposal. In the areas where I offer modifications or alternatives, I have done so in order to further minimize the potential negative impact on consumers.

Overall, I believe that my ideas are complementary to yours in many respects, and will help ease the transition to a new competitive environment with minimum impact on consumers. Below is a discussion of your thoughts, as I understand them, and my endorsements and/or suggested modifications. Please note that my comments are not made on behalf of the Universal Service Joint Board or the Florida Public Service Commission; they are simply my personal responses to your request for comments.

Letter to Chairman Hundt  
March 27, 1997

## **I. UNIVERSAL SERVICE**

My understanding of your current thoughts on interim implementation of the Universal Service provisions are as follows:

- FIRST: Schools, libraries, low income, and rural health care would be fully funded with interstate revenues only (cost  $\pm$  \$3 billion).
- SECOND: The current high cost fund (HCF) for small rural companies would be fully funded with interstate revenues only (cost  $\pm$  \$.55 billion).  
*NOTE: It was unclear to me whether under your proposal the current high cost fund for price cap companies would be fully funded with interstate revenues only (cost + \$.2 billion).*
- THIRD: Proxy models will be deferred for some time for further refinement.
- FOURTH: An interim HCF would be used until a decision is made on proxies.
- FIFTH: Even though you would only use interstate revenues for universal service in the interim, the Commission would assert its legal authority to assess both intra- and interstate revenues to fund a permanent mechanism.
- SIXTH: Long-term support (LTS) payments and dial equipment minutes (DEM) weighting should be removed from access charges and put into the USF ( $\pm$  \$.7 billion).
- SEVENTH: Although you made some suggestion of funding 25% of the HCF through interstate revenues, you solicited proposals for an interim high cost fund mechanism.

### **Interstate Funding**

Although you may have the authority to assess both intra- and interstate revenues for the Universal Service Fund, I believe your suggestion of only assessing interstate revenues for the interim fund is a wise one. Several states have raised legitimate legal issues as to whether the FCC has the authority to assess intrastate revenues. Additionally, even states that did not object to the assessment of inter-/intrastate funding raised questions as to the scope of the FCC's authority.

Letter to Chairman Hundt  
March 27, 1997

Some states were concerned about the magnitude of the subsidy dollars flowing from their states; others were concerned about the impact that an inter-/intrastate fund would have on their ability to create their own intrastate USF. There were numerous other legitimate concerns that have been raised by the states -- all of which cannot be answered by May 8th. The issue will and should be decided by the courts. Given the unresolved legal issues and the many concerns raised by the states, the better policy decision for the interim fund is to assess only interstate revenues -- even if you have the legal authority to assess both.

I believe that, in the long run, the better policy decision is to allow an assessment on both inter- and intrastate revenues for several reasons. First, the definition of universal service has now been expanded to services that were not previously included. Many of the services in the new definition are more intrastate than interstate in nature. Second, states will be allowed to assess both inter- and intrastate revenues for any intrastate universal service funds that are developed. Third, assessing both revenues will discourage companies from declaring interstate revenues as intrastate to avoid the assessment. Fourth, as competition develops over time, state and federal jurisdictional distinctions will become more difficult.

As discussed above, however, I am convinced that assessing only interstate revenues is the proper course of action in the short run, given the fact that under your proposal the current HCF will remain in place. Thus, the high cost states and high cost companies will not be detrimentally impacted during the interim.

#### **Interim Mechanism**

I fully support your suggestion that the FCC continue to use the current HCF structure for the small companies until the proxy models can be further refined. I would, however, go one step further. Because the proxy models are not yet properly designed, I believe the price cap companies should also continue to use the HCF structure.

I would, however, suggest that during the interim the current HCF be modified in a few respects. First, I support changing the manner of assessment to one based on interstate revenues of all interstate telecommunications providers, as opposed to one based on presubscribed access lines of only interstate interexchange carriers. Second, disbursements should be made to all qualifying carriers based upon the incumbent LECs' costs. I understand that these modifications will not achieve complete competitive neutrality, but as an interim measure they will allow those competitors who wish to avail themselves of high cost assistance a method of doing so.

Letter to Chairman Hundt  
March 27, 1997

Moreover, because competition is not developing as rapidly as once anticipated, particularly in the high cost areas, I believe this interim mechanism is sufficient and will harm neither the development of competition nor consumers. Finally, I propose that the calculation of HCF support be based on a calculated amount of income tax expense rather than the per book amount of income tax expense. This will target high cost funds more correctly towards those companies in need.

### **Long-Term Support and DEM Weighting**

You have suggested that LTS and DEM weighting should be removed from access charges and recovered as a part of the USF. I agree with your suggestion because LTS and DEM weighting are clearly distinct and measurable support mechanisms specifically designed to help small LECs. Therefore, they are good vehicles for immediately meeting the explicit support requirements of the Act.

Although I generally support restructuring the recovery of LTS and DEM, I ask that the FCC cautiously proceed with its restructuring efforts. While I recognize that the Act requires that all implicit subsidies be made explicit, I do not believe that restructuring should occur in isolation. In my view, implementing the Act requires us not only to make implicit support explicit, but also obliges us to examine what comprises the current amount of implicit support contained in interstate access charges. Such an examination will allow a determination to be made as to the appropriateness of continuing the current amount of support prior to shifting it to explicit support mechanisms. My fear is that substantial restructuring before proper cost reviews are conducted will simply "institutionalize" today's level of cost recovery and will ultimately result in consumers paying too much for their telephone service.

Below is a summary of my thoughts on the interim US:

#### **1. *Interim Universal Service Funding Levels***

- The US should be funded by a surcharge on the interstate revenues of all interstate telecommunications providers. This would equal an estimated 6% surcharge, which would fund the following:

Schools and Libraries	≤ \$2.25 billion
Low Income	± .50 billion
Health Care	± .25 billion *

Letter to Chairman Hundt  
March 27, 1997

HCF	± .75 billion
LTS	± .40 billion
DEM	± <u>.30 billion</u>
<b>US TOTAL</b>	<b>± \$4.45 billion</b>

\* The magnitude of funding for this category is purely speculative at this time.

**2. *Universal service programs for schools and libraries, low-income, and rural health care***

- By June/July 1997, implement the Joint Board's recommendation for schools and libraries, except that the funding base should be interstate revenues only.
- By January 1, 1998, implement the Joint Board's recommendation for low income and rural health care funding, except that the funding base should be interstate revenues only.  
This date will allow time to further develop the mechanisms for implementing this part of the Act.

**3. *Interim High Cost Fund***

The following timetable assumes that price cap LECs will move to a competitively neutral model on July 1, 1999. Small LECs will move to the USTA/RTC proposal on January 1, 2000, and will then move to a competitively neutral model on January 1, 2002.

- Price Cap LECs should remain under the current HCF (with suggested modifications) until July 1, 1999. (2 years)
- Small LECs should remain under the current HCF (with suggested modifications) until January 1, 2000. (2.5 years)
- January 1, 2000 - January 1, 2002 - implement LEC Joint Association Transition Plan (USTA/RTC) for small LECs.
- In addition to the changes that would be made to the HCF as recommended by the LEC Associations, the calculation of HCF support should be based on the calculated amount of income taxes as opposed to the per book amount of income taxes. The current method of

Letter to Chairman Hundt  
March 27, 1997

including a portion of book income taxes is not appropriate. A company that is earning an excessive rate of return will have a high level of income taxes on its books. Under current rules, that high level of income tax expense is included in a company's loop costs, and results in an even higher level of costs and HCF support for that company. Providing even more HCF support to a company which already has excessive earnings is contrary to the goals of the HCF. Instead, I recommend that income taxes related to the return component on investment be calculated for each company as is currently done in most pooling arrangements. This will allow an amount of income tax expense which is appropriate for the amount of investment allowed. This would be applicable to both rural and non-rural LECs as long as they remain on the current HCF. This change should be implemented January 1, 1998.

The above timetable will allow sufficient time to address the necessary separations and access reform issues, as well as to conduct federal price cap reviews. (I will discuss separations, access reform and federal price cap review in the following sections.) In addition, the proxy cost models should have been developed and the results reviewed by that time. Also, this will allow adequate time to review other competitively neutral methods for determining and distributing universal service funding, such as competitive bidding.

## **II. ACCESS REFORM**

My understanding of your current thoughts is that you would like to propose both structural and rate level changes in access charges. More specifically, my understanding is as follows:

- FIRST:        You propose to remove LTS and DEM weighting from access charges and recover those amounts through the US.
- SECOND:      You propose to provide actual dollar reductions to the CCL by removing pay phone cost recovery as a result of deregulation.
- THIRD:        You propose that the CCL charge be changed from a minute-of-use charge to a flat charge. This flat charge -- the FERC -- would be imposed as a per-line charge assessed to IXC's.

Letter to Chairman Hundt  
March 27, 1997

FOURTH: There are suggestions that other non-traffic sensitive access costs could be restructured into the FERC.

#### **Restructuring LTS and DEM Weighting/Real Monetary Reductions**

As discussed in the Universal Service section, I support the restructuring of LTS and DEM from access charges into a universal service surcharge. I believe that the restructured amounts represent a significant first step towards making implicit subsidies explicit. Additionally, the reduction in access charges resulting from such restructuring, coupled with the reduction due to pay phone deregulation, represents a good first step towards reducing the current level of interstate access charges. Furthermore, it is my understanding that access charges are traditionally reduced by current year price cap excess earnings. These reductions, including the price cap excess earnings ( $\pm$  \$.4 billion), equal a total effective reduction in access charges of \$1.4 billion.

LTS	$\pm$ \$.4 billion
DEM	$\pm$ .3 billion
Pay phone	$\pm$ .3 billion
Excess Price Cap	$\pm$ <u>.4 billion</u>
<b>TOTAL</b>	<b><math>\pm</math> \$1.4 billion</b>

#### **Restructuring CCL**

You have suggested that the CCL be changed from a minute-of-use charge to a flat rate charge, or FERC. You further suggested that the flat charge could be imposed as a per-line charge assessed to IXCs.

I agree that the MOU charge should be changed. In fact, my initial reaction to the FERC was a positive one, since it appeared to be a more cost based rate element; however, upon further review, I do not believe non-traffic sensitive (NTS) access costs should be assessed to IXCs on an access line basis. I believe that such an assessment could be too easily passed through as a separate line item charge on customers' bills, thereby appearing to be a local rate increase.

Specifically, today some IXCs offer basic toll service that requires a minimum flat rate payment regardless of the toll calls made. However, the companies also offer packages that waive the minimum flat rate charge for high volume customers. Assessment of the FERC on a per-line



Letter to Chairman Hundt  
March 27, 1997

basis would make it easy for the IXC's to pass the charge on as a separate line item to low volume customers who subscribe only to basic toll service, but to waive it for customers who subscribe to high volume packages. Furthermore, once the line item is on customers' bills, companies will have little incentive to reduce the flat rate amount, even if CCL costs decrease. As a state commissioner, I am very concerned about this inequity.

One of the arguments for calculating a FERC or other NTS-based charge on a per-line basis is that it would accurately reflect the underlying costs. I don't believe this is completely accurate. By nature, NTS costs are incurred in large blocks, and do not have a linear one-to-one relationship with access lines.

I propose that NTS costs be bulk-billed to the IXC's. I believe bulk billing is a superior restructuring mechanism to an explicit per-line FERC. Bulk billing will make it more difficult for IXC's to pass the costs on to consumers as a separate line item charge. Bulk billing to the IXC's will also give them the incentive to monitor costs so the amount assessed to them decreases as costs decrease.

Although bulk billing could also be based on access lines, I would prefer some other basis. For example, total NTS costs could be calculated, then divided among IXC's based on a market share measure. It could then be adjusted annually by some growth measure.

I believe bulk billing would provide the proper signal to IXC's that this is a bulk cost, incurred in blocks larger than a single access line. IXC's could recover this cost in any manner but a bulk bill would not create as easy an avenue to pass through the cost as a "tax" on a per-line basis.

I understand the difference may be semantic (especially if bulk billing is based on a per-line amount), but I believe we should consider creating mechanisms that do not create a convenient pass-through charge to end users. I propose that the chosen access charge structure should avoid the appearance of creating pass-through charges. The FCC order should make it clear that it does not intend to create another Subscriber Line Charge with this element.

While I am on the subject of the Subscriber Line Charge (SLC), I do not believe that the SLC should be increased for second residential lines or business lines in order to lower the CCL. While I agree that the CCL should be reduced over time, it should only be reduced after an examination of the costs and allocation procedures. My concern is that restructuring rates before the proper cost reviews have been conducted may result in consumers paying inappropriately high rates. I am

Letter to Chairman Hundt  
March 27, 1997

particularly concerned because the second residential line generally costs less to provide than the first, yet consumers will be charged a higher rate. Similarly, since business lines are already priced well above their costs, I am opposed to further increasing their rates until after proper cost reviews have been conducted.

I understand and support the FCC's interest in assuring that access rates and interconnection rates are similar, as well as its strategy for restructuring and/or reducing access rates to meet that goal. I do not believe, however, that a system needs to be implemented immediately to bring the rates to parity. I believe that further access reform, such as restructuring the TIC or local switching rates, or increasing the SLC, should occur after a review of federal price cap levels and structure for all major LECs.

#### **Interstate Price Cap and Productivity Factor Review**

The FCC acknowledged the possibility of an interstate price cap and productivity review when it issued its NPRM for access reform in December. Among many things, the FCC asked whether the price cap indices should be reinitialized through analysis of TSLRIC or other methods. The Commission asked whether analyses of rate of return, cost of capital, productivity inputs, embedded cost recovery, and other factors should be performed in light of the 1996 Act. I believe that such an analysis *should* be undertaken.

I believe the analysis is crucial to restructuring access charges in a meaningful way instead of simply shifting access charge contribution into the USF. While I recognize that we must move from implicit to explicit subsidies for universal service, I am not aware of any empirical evidence that shows the extent to which current interstate access charges act as implicit subsidies for universal service. I believe it is critical that such an analysis occur before additional access charge reductions or restructuring beyond what is recommended in this proposal are ordered.

I recognize that this will be a substantial undertaking. I suggest that the FCC solicit help from states in analyzing the information needed to reinitialize its price cap indices. Several states have staff that are well-versed in analyzing TSLRIC studies, productivity factors, and depreciation rates. We could be an invaluable resource in helping with the behind-the-scenes work that will be necessary for comprehensive review. I believe that the new partnership the FCC and states have forged could be put to good use in this area.

Letter to Chairman Hundt  
March 27, 1997

### **III. SEPARATIONS**

As it relates to separations reform, I applaud you for convening a meeting of the Federal/State Separations Joint Board to begin taking public comments on separations reform. In my opinion, the Separations Joint Board is comprised of this nation's best and brightest state regulatory commissioners. I am certain that a Joint Board review of the current separations rules will provide the FCC with additional options for reforming access.

Over the years, many have argued that costs are over allocated to the interstate jurisdiction, and that cost misallocations heavily contribute to problems with the CCL, TIC, and local switching elements of access charges. I agree that some of the problems with access charges are the result of the jurisdictional separations rules.

I am concerned that if our current separations rules are not changed, many of the current problems are likely to become restructured or embedded into explicit support mechanisms. While on the surface restructuring appears to be pro-competitive, if the restructured costs are over allocated, consumers will not see the benefits of competition, but will be unfairly burdened by overly inflated prices caused by a flawed regulatory process. I am concerned that if we continue to restructure without reviewing our separations rules, once the costs become embedded in universal service or restructured into a flat rate charge, neither the IXC's nor the LEC's will care that the costs are over allocated. The consumer, however, will suffer by being charged too much through the USF, the FERC, the SLC, or any other explicit mechanism that may be used. I firmly believe that the Separations Joint Board process will provide federal and state regulators an opportunity to set up a proper regulatory process.

Additionally, through the Joint Board process, the FCC will have an opportunity to address the appropriateness of the current interstate gross allocator percentage of 25%, and make a determination as to whether it should remain the same, increase, or decrease. Although the correct answer can only be obtained after a review of the separations rules, it is possible that the gross allocator may need to be changed. Even if greater costs were to be shifted to the intrastate jurisdiction, this would allow for a more tailored analysis of cost recovery on a state-by-state basis, as opposed to a federal "one-size-FERCs-all" approach.

While in the long run the need for separations may diminish, I believe that during this transition it plays a necessary role in leading to a competitive environment. With this in mind, I

Letter to Chairman Hundt  
March 27, 1997

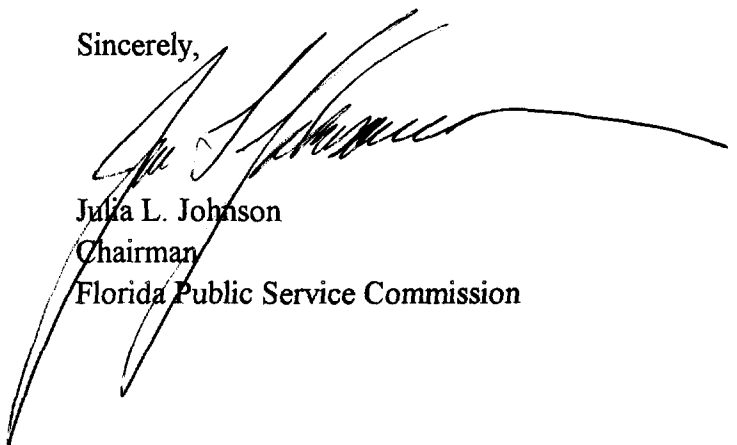
recommend that the FCC initiate a formal proceeding to review existing separations procedures for possible modifications as soon as possible.

#### **IV. CONCLUSION**

Thank you again for reaching out to the states and asking us to provide you with our thoughts and ideas on the FCC's implementation of the federal Act. Although you recognize that there are numerous ways to accomplish the FCC's responsibilities under the Act, you have asked the states to help you create a collective solution.

The thoughts as expressed above are my attempt to respond to your request. I have also attached a timetable that codifies an implementation schedule for my ideas.

Sincerely,



Julia L. Johnson  
Chairman  
Florida Public Service Commission

<b><i>June 1, 1997</i></b>	<p>Begin review of separations rules and price cap structure.</p> <p>Continue to develop proxy or other competitively neutral models for HCF support.</p>
<b><i>June/July 1997</i></b>	<p>Implement funding for schools and libraries.</p> <p>“Phase I” of access charge reform: restructure CCL and any other non-traffic sensitive (NTS) access costs to flat rate bulk billing to IXC.</p>
<b><i>December 31, 1997</i></b>	<p>80-286 Joint Board recommendation on separations reform due.</p>
<b><i>January 1, 1998</i></b>	<p>Implement funding for low-income programs and rural health care providers.</p> <p>Decrease access charges by \$1.4 billion.</p> <p>Begin collecting HCF support revenues from all interstate carriers and distribute support to any qualifying carrier based on incumbent LEC costs as determined by current HCF mechanisms.</p> <p>Implement income tax expense change to HCF.</p>
<b><i>May 1, 1998</i></b>	<p>FCC decision on separations reform.</p> <p>Complete review of price cap structure.</p> <p>Begin “Phase II” of access charge reform - possible rate reductions as a result of separations reform and price cap method review.</p> <p>Final decision on permanent HCF mechanism (proxy, competitive bidding, etc.)</p>
<b><i>December 1, 1998</i></b>	<p>Complete access charge reform.</p>
<b><i>January 1, 1999</i></b>	<p>Implement separations reform.</p>
<b><i>July 1, 1999</i></b>	<p>Implement revised High Cost Fund for price cap LECs.</p>

- January 1, 2000***      Implement interim HCF as proposed by the LEC Associations for the rural LECs.
- January 1, 2002***      Implement revised High Cost Fund for small/rural LECs